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Antitrust—Clayton Act—Delineation of the Relevant Market under Section 7.—Reynolds Metals Co. v. FTC

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CASE NOTES

Antitrust—Clayton Act—Delineation of the Relevant Market under Section 7.—*Reynolds Metals Co. v. FTC.*[1]—Petitioner, Reynolds Metals Company, an integrated producer of aluminum, is the largest producer of aluminum foil in the world.[2] Reynolds and other major raw foil producers sell in quantity to intermediaries known as converters, who purchase "jumbo" rolls, break them down, and process them with decorative and other features sought by the end users. Arrow Brands, Incorporated, a converter engaged in selling processed foil to wholesale florist supply houses throughout the country, was acquired by Reynolds in 1956. At the time of the acquisition, while roughly 200 foil converters were active in the United States, only eight, including Arrow, served the florist industry. Of approximately 192 million pounds of domestic converted foil shipped in 1956, roughly 9.7 million pounds was composed of decorative foil of all kinds and less than 1.5 million pounds or about two million dollars was consumed by the florist foil trade. Arrow accounted for thirty-three per cent of these total sales. Although decorative foil, as such, may be used for tape, candy box liners, covers for take-out food stuffs and many other purposes, it is not physically distinguishable from florist foil which is used mainly to decorate flower pots. All decorative foil, including florist foil, is gauged at approximately the same thickness, .00065 inches.[3]

In a proceeding instituted by the Federal Trade Commission, in which Reynolds was charged with a violation of Section 7 of the Clayton Act,[4] the Commission's examiner found that Reynold's acquisition of the stock and assets of Arrow would have the effect of substantially lessening competition in the production and sale of aluminum foil to the florist trade, and divestiture of certain stock and assets of Arrow was ordered. In measuring the anti-competitive effects of the merger, the examiner did not base his findings on the fact that thirty-three per cent of the florist foil converting industry would be foreclosed to other manufacturers of raw foil. Rather, actual anti-competitive effects were found to have occurred, "where as an apparent consequence of retroactive price reductions for Arrow foil after the acquisition . . . florist foil sales of five of Arrow's seven competitors had by 1957 dropped from 14% to 47% below 1955 sales. Arrow sales over the same period increased by 18.9%."[5]

On appeal, Reynolds contended that the Commission erred in defining the relevant market in which to measure the competitive effects of the merger and in holding that florist foil was the relevant line of commerce. The Court of Appeals affirmed the Commission's cease and desist order. HELD: Although florist foil is not distinguishable from decorative foil on the basis of *use*

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[1] Trade Reg. Rep. ¶ 70,471 (D.C. Cir. 1962).

[2] Reynolds' foil production of 117 million pounds per year formed 40.5% of the total foil production in the United States. In 1957 Reynolds led the Aluminum Company of America by 37 million pounds in capacity for foil production. Kaiser Aluminum and Chemical Corporation was third.

[3] Supra note 1, at ¶ 76,928.

[4] 38 Stat. 731 (1914), as amended, 64 Stat. 1125 (1950), 15 U.S.C. § 18 (1958).

[5] Supra note 1, at ¶ 76,926.

and *quality*, in terms of (1) public and industrial recognition of it as a separate economic entity, (2) its distinct pricing and (3) its distinct customers, florist foil markets may be legitimately separated from aluminum foil markets generally, and thus may be appropriately viewed as the area in which the proscribed activity occurred.

In the twelve years that have elapsed since the adoption by Congress of the celebrated Celler-Kefauver Amendments to Section 7 of the Clayton Act,[6] such terms as "product interchangeability," "cross-elasticity of demand" and "production flexibility" have become increasingly important struts within the framework of section 7 litigation. In effect, the basic objectives behind the 1950 act were three: (1) to "plug the loophole"[7] that had existed under the 1914 act, which applied only to the acquisition of stock of other corporations and did not apply to direct acquisitions of assets; (2) to delete the "acquiring-acquired" language of the original section, with the consequent congressional indication that section 7 would not only apply to horizontal mergers,[8] but also to vertical[9] and conglomerate mergers[10] which may tend to lessen competition in any line of commerce in

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[6] For a comparison of the original and amended section 7, brackets indicate deletions, italics indicate additions.

> That no corporation engaged in commerce shall acquire, directly or indirectly, the whole or any part of the stock or other share capital *and no corporation subject to the jurisdiction of the Federal Trade Commission shall acquire the whole or any part of the assets* of another corporation engaged also in commerce, where *in any line of commerce in any section of the country*, the effect of such acquisition may be [to] substantially *to* lessen competition [between the corporation making the acquisition, or to restrain such commerce in any section or community], or *to* tend to create a monopoly [of any line of commerce].

Supra note 4.

[7] "The bill is not complicated. It proposes simply to plug the loophole in sections 7 and 11 of the Clayton Act." Hearings on H.R. 515, 80th Cong., 1st Sess. 4 (1947). The Senate Report on the measure summarized the "Purpose" of the amendment as follows: "Since the acquisition of stock is significant chiefly because it is likely to result in control of the underlying assets, failure to prohibit direct purchases of the same assets has been inconsistent and paradoxical as to the over-all effect of existing law." S. Rep. No. 1775, 81st Cong., 2d Sess. 2 (1950).

> [8] An economic arrangement between companies performing similar functions in the production or sale of comparable goods or services is characterized as 'horizontal' . . . . Where the arrangement effects a horizontal merger between companies occupying the same product and geographic market, whatever competition previously may have existed in that market between the parties to the merger is eliminated.

Infra note 16, at 334-35.

> [9] Economic arrangements between companies standing in a supplier-customer relationship are characterized as 'vertical.' The primary vice of a vertical merger or other arrangement tying a customer to a supplier is that, by foreclosing the competitors of either party from a segment of the market otherwise open to them, the arrangement may act as a 'clog on competition' . . . which 'deprive[s] . . . rivals of a fair opportunity to compete' . . . . Every extended vertical arrangement by its very nature, for at least a time, denies to competitors of the supplier the opportunity to compete for part or all of the trade of the customer-party to the vertical arrangement.

Infra note 16, at 323-24. The Reynolds-Arrow merger is an example of a vertical merger.

[10] This type of merger involves two companies operating on different functional levels either in different geographic markets or different industries. Its effects are more

any section of the country;[11] (3) to stem the rising tide of economic concentration in the American economy[12] by creating an effective tool for preventing all mergers having demonstrable anti-competitive effects.[13]

Nevertheless, Congress' failure to address itself specifically to the question of precisely what would have to be demonstrated in order to establish a section 7 violation[14] and the courts' reluctance to engage in economic analyses have apparently provided the Government with an indefensible weapon rather than a useful tool, as was originally conceived.[15] The *Reynolds* case is strikingly reflective of the economic oversimplification effectuated by the judiciary. The impact of the decision, particularly following in the heels of the *Brown Shoe* opinion,[16] is clear. However, before discussing the case and its ramifications, it would be best to lay the groundwork by defining the above-mentioned section 7 terms.

Determination of the relevant market in which to predict the probable competitive effect of a merger is a prerequisite to finding a violation of section 7.[17] Yet, the problem of defining the boundaries of the relevant market is subtle and revolves on discovering patterns of trade which are

likely to be felt in the horizontal markets of the merging firms. Congress recognized the likely effects of such a merger, although referring to it as a "forward-vertical" acquisition: "If, for example, one or a number of raw material producers purchases firms in a fabricating field and if as a result thereof competition in that fabricating field is substantially lessened in any section of the country, the law would be violated." H.R. Rep. No. 1191, infra note 11.

11 H.R. Rep. No. 1191, 81st Cong., 1st Sess. 11 (1949).

12 That the current merger movement [during the years 1940-1947] has had a significant effect on the economy is clearly revealed by the fact that the asset value of the companies which have disappeared through mergers amounts to 5.2 billion dollars, or no less than 5.5 per cent of the total assets of all manufacturing corporations—a significant segment of the economy to be swallowed up in such a short period of time.

Id. at 3.

13 The bill is intended to permit intervention . . . when the effect of an acquisition may be a significant reduction in the vigor of competition, even though this effect may not be so far reaching as to amount to a combination in restraint of trade, create a monopoly, or constitute an attempt to monopolize. Such an effect may arise [by an] increase in the relative size of the enterprise . . . to such a point that its advantage over its competitors threatens to be decisive, undue reduction in the number of competing enterprises, or establishment of relationships between buyers and sellers which deprive their rivals of a fair opportunity to compete.

H.R. Rep. No. 1191, supra note 11, at 8.

14 Section 7's lack of qualitative or quanitative tests was a prime target of attacks by opponents of the measure. See, e.g., S. Rep. No. 1775, supra note 7, at 20-21 (dissenting views of Senator Donnell).

15 It would be impossible in the space allotted to trace the amended section 7's judicial metamorphosis. There are, however, numerous articles on the general subject. E.g., Bok, Section 7 of the Clayton Act and the Merging of Law and Economics, 74 Harv. L. Rev. 226 (1960); Handler, Quantitative Substantiality and the Celler-Kefauver Act—A Look at the Record, 7 Mercer L. Rev. 279 (1956); Handler & Robinson, A Decade of the Administration of the Celler-Kefauver Anti-Merger Act, 61 Colum. L. Rev. 629 (1961); Lewyn & Mann, Ten Years Under the New Section 7 of the Clayton Act (1961).

16 Brown Shoe Co. v. United States, 370 U.S. 294 (1962).

17 United States v. E. I. duPont de Nemours & Co., 353 U.S. 586, 593 (1957).

followed in practice.[18] Accordingly, the delineation of the relevant market must be made on a case by case basis.[19] Although the statute does not contain the word "market," it does specify the two basic dimensions of a relevant market; (1) the product dimension, designated by the phrase "line of commerce" and (2) the geographic dimension, designated by the phrase "section of the country."[20] Until recently the test for delineating the product dimension of the relevant market involved measuring the interchangeability of products from other markets with those in the market which the Government was seeking to define and limit,[21] as well as the cross-elasticity of demand between the product itself and substitutes for it.[22] Consequently, the geographic dimension was considered to be subordinate to the product dimension in that the sales area would often be governed by product interchangeability.[23] Also tied to the inquiry as to interchangeability was the concept of "production flexibility." Supporters of this doctrine contend that if manufacturers of the product which the Government has selected as the relevant market have the facilities to easily shift production to other items, then these items should also be included within the relevant market. This test, although successfully applied in *United States v. Columbia Steel Co.*,[24] was rejected in later cases.[25]

After the delineation of the "line of commerce" has been made, it is then necessary to determine the actual or probable competitive effects of the merger.[26] These effects will vary to some extent according to the type of merger

18 United States v. United Shoe Machinery, 110 F. Supp. 295, 303 (D. Mass. 1953), aff'd per curiam, 347 U.S. 521 (1954); United States v. Bethlehem Steel Corp., 186 F. Supp. 576, 588 (1958).

19 United States v. Brown Shoe Co., 179 F. Supp. 721, 730 (E.D. Mo. 1959).

20 United States v. Bethlehem Steel Corp., supra note 18, at 587-88.

21 "The market which one must study to determine when a producer has monopoly power will vary with the part of commerce under consideration. The tests are constant. That market is composed of products that have reasonable interchangeability for the purposes for which they are produced—price, use and qualities considered." United States v. E. I. duPont de Nemours & Co., 351 U.S. 377, 404 (1956).

22 A prime factor to be considered in determining the cross-elasticity of demand between products is the responsiveness of the sales of one product to price changes of the other. As the Supreme Court pointed out in one case: "If a slight decrease in the price of cellophane causes a considerable number of customers of other flexible wrappings to switch to cellophane, it would be an indication that a high cross-elasticity of demand exists between them; that the products compete in the same market." Id. at 400.

23 Erie Sand & Gravel Co. v. FTC, 291 F.2d 279 (3d Cir. 1961). The importance of product interchangeability in governing the section of the country in which the competitive effects of the merger are to be measured was borne out in Crown Zellerbach Corp. v. FTC, 296 F.2d 800 (9th Cir. 1961). There the court rejected product interchangeability and classified the relevant market as "census coarse papers" thus encompassing an eleven state area rather than all the states west of the Mississippi, as would have been the case had "trade coarse papers" been included in the relevant product market.

24 334 U.S. 495 (1948).

25 United States v. Bethlehem Steel Corp., supra note 18; Crown Zellerbach Corp. v. FTC, supra note 23.

26 It is interesting to note that there are those who would apply a "quantitative substantiality" test to every type merger (see Handler, supra note 15). The test would result in a per se violation of section 7 should it be found that the merger resulted in a capture of a certain percentage or share of the relevant market. The term "quantitative

consummated, *i.e.*, horizontal,[27] vertical[28] or conglomerate.[29]

Formerly, "reasonable interchangeability," "cross-elasticity of demand" and "production flexibility" were major defenses to a section 7 suit. By employing these devices, the defense was permitted to delineate a broad market and thereby show minimum competitive injury as a result of the merger. As a consequence of a series of section 7 suits,[30] culminating in the instant case, the effectiveness of these defensive weapons appears to be sharply reduced if not entirely wanting. The use of the "reasonable interchangeability" or "substitute products" concept received its greatest legal impetus in the 1956 *Cellophane* decision[31] which concerned the Sherman Act.[32] In that case, the Supreme Court defined the relevant market as flexible packaging materials rather than cellophane itself. The importance of the "reasonable interchangeability" concept to the respondent's defense in that case can be seen when considering that cellophane itself constituted less than twenty per cent of the relevant market, but duPont manufactured nearly seventy-five per cent of all cellophane products. In the *duPont-General Motors* case,[33] a pre-1950 section 7 proceeding, the Supreme Court did not discuss "reasonable interchangeability" but rather held that "automotive finishes and fabrics . . . [were] sufficiently distinct from all other finishes and fabrics to make them a 'line of commerce' within the meaning of the Clayton Act."[34] Again the importance of "reasonable interchangeability" is emphasized, for had the Court accepted the concept, duPont would have been found to have accounted for only 3.5 per cent and 1.6 per cent of all the industry sales of finishes and fabrics, respectively,[35] rather than the approximately thirty-four per cent and nineteen per cent of the automotive finish and fabric business which the Court found traceable to duPont.[36] In the *Crown-Zellerbach* case,[37] the "reasonable interchangeability" doctrine was again rejected, the court holding that census coarse paper was the relevant market rather than the broader trade coarse paper line of commerce. Again in the recent *Brown Shoe* opinion,[38] the Supreme Court dispelled any doubts as to the effectiveness of a "reasonable interchangeability" or a "substitute products" defense. Although the approach taken was different than in prior cases, the effect was the same. The Court acknowledged that the broad product market is to be determined

substantiality" developed from cases decided under Section 3 of the Clayton Act, which relates to tie-ins and exclusive dealing contracts. See Standard Oil Co. v. United States, 333 U.S. 293 (1949); International Salt Co. v. United States, 332 U.S. 392 (1947).

27 For a definition of horizontal mergers, see supra note 8.

28 For a definition of vertical mergers, see supra note 9.

29 For a definition of conglomerate mergers, see supra note 10.

30 Brown Shoe Co. v. United States, supra note 16; United States v. E. I. duPont de Nemours & Co., supra note 17; United States v. E. I. duPont de Nemours & Co., supra note 21; Crown Zellerbach Corp. v. FTC, supra note 23.

31 Supra note 21.

32 26 Stat. 209 (1890), as amended, 69 Stat. 282 (1955), 15 U.S.C. § 1 (1958).

33 Supra note 17.

34 Id. at 592.

35 Id. at 593.

36 Id. at 596.

37 Supra note 23.

38 Supra note 16.

by the use of the "reasonable interchangeability" and "production flexibility" concepts. However, the Court went on to say that "within this broad market, well defined submarkets may exist which, in themselves, constitute product markets for anti-trust purposes . . . because Section 7 of the Clayton Act prohibits any merger which may substantially lessen competition in *any* 'line of commerce'."[39] Consequently, the Court rejected the claim that "footwear" should be the relevant market and held the line of commerce to be "men's, women's and children's shoes."

Thus the *Reynolds* decision should come as no surprise. *Brown* suggested that "the boundaries of . . . a submarket may be determined by examining such practical indicia as industry or public recognition of the submarket as a separate economic entity, the product's peculiar characteristics and uses, unique production facilities, distinct customers, distinct prices, sensitivity to price changes and specialized vendors."[40] The Court of Appeals for the District of Columbia has now applied these indicia to the instant case.

Despite agreeing with the petitioner's contention that florist foil can not be distinguished from decorative foil on the basis of physical characteristics and use, the court held that the florist foil converting industry was a distinctly separable line of commerce based upon distinct pricing, purchaser identity, and industry and consumer recognition. It would seem to follow that if the products are similar in all respects, pricing and consumer identity should also be indistinguishable. This then would appear to be the anomaly of the decision. The court does not come to grips with the reasons behind the pricing structure of aluminum foil, although it is obvious that there is more to the situation than meets the eye. Had the court delved into the economic considerations of the situation and attempted to pry loose the reason for the failure of decorative foil consumers to substitute and thereby gain price advantage (although in most cases paying prices of thirty per cent to forty per cent higher than those charged to consumers of florist foil), then perhaps a different decision might have resulted.

Whereas *Reynolds* makes it clear that the concept of "reasonable interchangeability" is passing from the section 7 scene, it would also appear that *Reynolds* has "mothered" a new concept. As *Brown Shoe* had suggested that submarkets might exist within the broad market for section 7 purposes, *Reynolds* suggests that "*actual* interchangeability" is a prime factor that must be considered within the wider and decaying concept of "reasonable interchangeability." The court, in determining the relevant market, decided that since consumers did not *actually* interchange or substitute florist foil for decorative foil, or vice versa, their failure to do so limited the "line of commerce."[41] The additional factor of "*potential* interchangeability" of the foils was not considered.

Thus, *Reynolds* not only deprives defendants in section 7 suits of the use of "reasonable interchangeability," but also of the concept of "production

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[39] Id. at 325.
[40] Ibid.
[41] Supra note 1, at ¶ 76,927.

flexibility." For in viewing the relevant market from the consumer's viewpoint,[42] the court apparently deemed that "production flexibility," as viewed by the manufacturer, need not be reckoned with. In effect, *Reynolds* is following *Brown Shoe* in holding that even though a rival florist foil converter may easily shift to the manufacture of decorative foil, this will not aid a consumer of florist foil who must still purchase in a market where competition is substantially lessened.

This position seems highly untenable. Even assuming that consumer injury should be the prime concern of the courts, "production flexibility" need not be dispensed with. For, applying a converse "production flexibility" principle, if producers of another product are easily able to shift to the production of the product which the Government has selected as the relevant market (and this is the case here),[43] then injury to consumers is *de minimus*, if not totally illusory. Further, it is submitted that market injury is improbable in a situation where "product interchangeability" is apparently nonexistent *at the time of the suit*, but *future* "product interchangeability" seems likely. Thus in the instant situation, where *use* and *quality* of the two products are indistinguishable, "product interchangeability" seems imminent. The fact that a pricing disparity exists between the products is, of course, critical to the future interchangeability of the foils. In this light the court's failure to delve into the pricing structure of foil, generally, is even more glaring.

In conclusion, a submarket delineation concept as suggested in *Brown Shoe* and an "*actual* product interchangeability" test as applied in *Reynolds* allows the Government the opportunity to pick and choose a "line of commerce" in which to easily measure and prove actual or probable anticompetitive effects of a merger. It is apparent that such an advantage may well prove to be insurmountable.[44] If a section 7 suit is to remain clothed

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42 Again we find the instant court following the majority in *Brown* who were also more concerned with the interests of the consumer. Cf., Mr. Justice Harlan's separate opinion in *Brown* where he advocated the test of "production flexibility" as "a more realistic gauge of the possible anticompetitive effects [of a merger]." Supra note 16, at 367. The consumer viewpoint approach as taken by the *Brown* and *Reynolds* courts is a relatively recent development. As late as 1961 some courts viewed possible injury to competitors as their ultimate concern. Thus in *Crown Zellerbach* the court said:

> Congress was . . . concerned about the competitor, . . . the small business man whose 'little independent units are gobbled up by bigger ones,' and about other competitors whose opportunities to meet the prices of the larger concern and hence compete with it might be diminished by a merger which increased the concentration of power in the larger organization.

Supra note 23, at 825.

43 "The Government concedes that theoretically all 200 converters could supply florist foil . . . ." Supra note 1, at ¶ 76,924.

44 An example of such criticism is an article entitled "The Growing Threat of Antitrust" by Silvester Petro, which appeared in the November 1962 issue of Fortune magazine. The author quotes Professor Milton Handler of Columbia as saying, in regard to the FTC: "Today the Commission aspires to outlaw any business practice it regards as ethically wrong or economically undesirable. Just as we can not permit the past to rule the present, we can not accept the assertion of a censorious authority that knows no limits." Fortune, Nov. 1962, p. 130.

in the dignity of an adversary proceeding, it is submitted that a rebirth of the "*reasonable* product interchangeability" concept is needed.[45]

STUART R. ROSS

Antitrust—Sherman Act—Tie-in Contracts.—***United States v. Loew's, Inc.***[1]—In 1957, the United States brought separate actions under Section 4 of the Sherman Act[2] against six major distributors[3] of pre-1948 motion picture films which had been released for television exhibition. The defendants in each suit were charged with having engaged in "block booking"[4] in violation of Section 1 of the Sherman Act.[5] The Government sought injunctive relief prohibiting each defendant from refusing to sell or license feature films to television stations on an individual basis as well as such other relief as might be necessary for the restoration of competition. The district court entered separate decrees enjoining each distributor from conditioning the purchase or license of the right to exhibit any feature film upon the purchase or license of any other film and from entering into an agreement wherein the price differential between a desired film and a block of films was such that it had the effect of illegal block booking.[6] On appeal the film distributors, with the exception of National Telefilm, challenged

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45 It should be pointed out that two months following the Commission's divestiture order, Reynolds petitioned the Commission to reopen the proceeding for purposes of adducing new and additional evidence. Reynolds sought to introduce evidence that a division of Kaiser Aluminum & Chemical Corp. and a division of R. J. Reynolds Tobacco Co. had expanded their florist foil activities since the close of hearings in October 1958. Reynolds hoped to show that these new entries, having competitive strength comparable to Reynolds, reinforced its argument that the acquisition of Arrow had not had the effect of a probable lessening of competition or a tendency toward a monopoly.

In denying the petition (Matter of Reynolds Metals Co., FTC Docket 7009, Opinion of Commission on Petition to Reopen Proceeding (March, 1960)) the Commission held, *inter alia*, that "Even though subsequent events may show that future competitive conditions are not as anticipated, this would not make legal that which was illegal, nor relieve the respondent of the consequences of its action, unlawful as of the time of trial." In an article entitled "Significant New Commission Developments" (17 A.B.A. Antitrust Section 274, 276), Hon. Edward T. Tait, Commissioner, FTC, points out that "Broadly speaking, the Reynolds petition also raises serious questions in balancing the rights of a respondent as to after-discovered evidence with the necessity for some end to litigation."

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1 83 Sup. Ct. 97 (1962).

2 26 Stat. 209 (1890), 15 U.S.C. § 4 (1958).

3 The distributors were Loew's, Inc., C & C Super Corp., Screen Gems, Inc., Associated Artists Productions, Inc., National Telefilm Associates, Inc. and United Artists Corporation.

4 The complaints defined "block booking" as the licensing of feature films to television stations in a block whereby the licensing of one feature film is conditioned upon the licensing of one or more other feature films.

5 Section 1 of the Sherman Act, 26 Stat. 209 (1890), 15 U.S.C. § 1 (1958), provides in part: "Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal. . . ."

6 189 F. Supp. 373 (S.D.N.Y. 1960).